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ONTARIO

REPORT
on
THE MORTGAGES ACT
SECTION 16

ONTARIO LAW REFORM COMMISSION

DEPARTMENT OF JUSTICE 1971

The Ontario Law Reform Commission was established by section 1 of *The Ontario Law Reform Commission Act, 1964* for the purpose of promoting the reform of the law and legal institutions. The Commissioners are:

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Honourable James C. McRuer, S.M., LL.D., D.C.L.
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REPORT ON SECTION 16 OF THE MORTGAGES ACT

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ONTARIO

ONTARIO LAW REFORM COMMISSION

To: The Honourable Allan F. Lawrence, Q.C.,

Minister of Justice and
Attorney General for Ontario.

SECTION 16 OF THE MORTGAGES ACT

Dear Mr. Attorney:

Pursuant to section 2 (1) (*a*) of *The Ontario Law Reform Commission Act, 1964*, as a result of representations made to it the Commission initiated a study of section 16 of *The Mortgages Act*.[1] Concern was expressed that because of the way in which section 16 is drawn, where an incorporated builder erects and sells a private home and the purchaser assumes the burden of a mortgage given by the builder-vendor, that purchaser will not be entitled to the right to prepay after five years which is created by section 16. A working paper was prepared and circulated among solicitors, institutional mortgage lenders, and others active in the mortgage field. The comments received in response to the working paper formed the basis for further study. The Commission now submits its report.

[1] R.S.O. 1960, c. 245.

Section 16 reads as follows:

> 16.—(1) Where any principal money or interest secured by a mortgage of freehold or leasehold property is not, under the terms of the mortgage, payable till a time more than five years after the date of the mortgage, then, if at any time after the expiration of such five years any person liable to pay or entitled to redeem tenders or pays to the person entitled to receive the money the amount due for principal money and interest to the time of such tender or payment, together with three months further interest in lieu of notice, no further interest is chargeable, payable or recoverable at any time thereafter on the principal money or interest due under the mortgage.
>
> (2) This section does not apply to any mortgage given by a joint stock company or other corporation nor to any debenture issued by any such company or corporation for the payment of which security has been given on freehold or leasehold property.

Section 10 of the Canada *Interest Act*[2] employs similar terms. Although the Canada section differs in some respects from its Ontario counterpart in form of expression, the effect of the two sections is intended to be the same. Section 1 (*d*) of *The Mortgages Act* defines the term "mortgagor" to include any person deriving title under the original mortgagor or entitled to redeem a mortgage, according to his estate, interest or right in the mortgaged property. The person "liable to pay or entitled to redeem" mentioned in section 16 (1) will normally be a mortgagor. We shall hereafter refer to a person having such rights as a mortgagor.

The present meaning of subsection 1 in both the Canada and the Ontario Acts is reasonably clear. Where a mortgage is to run for longer than five years, at any time after five years the mortgagor can offer to pay off the money owing at that time together with three months interest. If the offer is not accepted by the mortgagee then no further interest will accrue. Since to refuse to accept the offer would be uneconomic for the mortgagee, in reality a mortgagor can pay off the debt owing at any time after five years.[3]

Uncertainty exists in relation to renewals of mortgages having terms of five years or less and as to the effect of the words "in lieu of notice", points which will be discussed later in this report. But these issues aside, the subsection has been little questioned either by the legal profession or by institutional mortgagees.

Despite the fact that neither the Canada nor the Ontario provision gives an express right to redeem, if a mortgagee accepts the payment tendered by the mortgagor, the debt secured by the mortgage thereby being satisfied, the mortgagor is entitled to as full and clear title to his

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[2]R.S.C. 1952, c. 156.

[3]He cannot, however, demand a discharge of the mortgage unless the mortgagee accepts payment: *Baxter* v. *Dercasz*, [1925] 3 W.W.R. 593 (Sask. C.A.); *Re Moore and Texaco Canada Ltd.*, [1965] 2 O.R. 253 (Ont. H.C.).

land as if the mortgage had never been. Once the reason for the mortgage has been removed, there is no cause for the mortgage to exist longer and equity will not permit its continuance.[4] There is no authority under the section to offer only a partial prepayment.

1. Constitutional Issues

Subsections 1 and 2 of section 10 of the *Interest Act* were enacted in 1880 and 1890 respectively. Since this legislation concerned mortgage contracts there was some doubt as to its constitutional validity. To allay this doubt the Ontario Legislature enacted subsection 1 of section 16 in 1903 and subsection 2 in 1910.

This raises a constitutional question as to the power of the province to enact, and now to amend section 16 of *The Mortgages Act*. If section 10 is a valid exercise of the federal power over interest, reserved to Parliament by section 91 (19) of the *British North America Act*, the provincial legislation is invalid.[5] Even if in the absence of a federal statute the province properly could treat the interest payable on a mortgage debt under the head "property and civil rights" (which is allocated to the provinces by section 92(13) of the *British North America Act*), the enactment of competent concurrent federal legislation would oust the provincial jurisdiction if it led to conflict or duplication between the federal and provincial laws. This prevalence of the expressed federal power in a case where there are both federal and provincial aspects to a challenged law is commonly referred to as the doctrine of paramountcy.[6]

The constitutionality of section 10 was upheld by Britton, J. in *Bradburn* v. *Edinburgh Assurance Co.*[7] and seems to have been assumed by Armour, C.J. in *Re Parker*, *Parker* v. *Parker*,[8] although in his work on mortgages Falconbridge doubted whether the reasoning of the *Bradburn* case could be justified on principle.[9] In holding the federal section valid, Britton, J. stated that he had not overlooked the argument that as a result of his conclusion the federal Parliament can legislate to limit any contract to the shortest duration where interest is involved. "It is, however," he continued, "one thing to legislate where the contract has sole reference to security for money lent at interest, and quite a different thing to legislate in reference to other contracts where interest is only an incident." By this he apparently refers to the "aspect doctrine",[10] whereby the pith, substance, character and purpose of challenged legislation determines whether it was validly enacted. Unfortunately,

[4] *Noakes and Co., Ltd.* v. *Rice*, [1902] A.C. 24; [1900-03] All E.R. Rep. 34, per Lord Macnaghten at A.C. page 30, All E. R. Rep. page 37.

[5] *Home Insce. Co.* v. *Lindal & Beattie*, [1934] S.C.R. 33, at page 40; *Lymburn* v. *Mayland*, [1932] A.C. 318, at pages 326-27. See also Lederman, "The Concurrent Operation of Federal and Provincial Laws in Canada" (1962-63), 9 *McGill L.J.* 185.

[6] *G.T.R.* v. *A.G. of Canada*, [1907] A.C. 65. See Laskin, *Canadian Constitutional Law* (3d ed. revised, 1969), at page 104 *et seq.*

[7] (1903), 5. O.L.R. 657. Notice of appeal was filed, but abandoned when the case was settled out of court.

[8] (1894), 24 O.R. 373.

[9] Falconbridge, *Law of Mortgages* (3rd ed., 1942), at page 647. See also Lefroy, *Canada's Federal System* (1913), at pages 275 to 277.

[10] See *Russell* v. *The Queen* (1882) 7 A.C. 829, and *A.G. for Canada* v. *A.G. for Alberta*, [1916] 1 A.C. 588.

it is not clear, even from reading the House of Commons debates preceding the enactment of section 10, whether the purpose of section 10 was to reduce the dollar amount of interest payable on mortgage debts (which would clearly be a federal matter) or to shorten the effective terms of mortgage debts (which would clearly be a provincial matter).

The province can avoid these issues. Under the existing Canada and Ontario legislation a mortgagee can refuse to accept the offered prepayment and suffer the loss of interest. All such a refusal accomplishes is to create a cloud on the mortgagor's title. To permit a mortgagee capriciously or maliciously to do so when the mortgagor is simply exercising a right given to him by statute cannot be justified. The Commission therefore recommends that section 16 (1) be amended deleting the clause causing interest to cease and providing that where a mortgagor (that is, a person liable to pay or entitled to redeem) could formerly have offered prepayment he may require acceptance of such prepayment and demand a discharge of the mortgage. In other words, the right of a mortgagor under section 16 (1) should be to demand redemption rather than to cause interest to cease.

II. Problem Raised by the Incorporated Builder-Vendor

The difficulty which prompted our study of section 16 of *The Mortgages Act* arises out of the way in which subsections 1 and 2 interact. Subsection 1 is intended to permit an individual to escape from a mortgage contract which may have become oppressive or uneconomic with the passage of time. Subsection 2 denies corporate long term borrowers the right to prepay under subsection 1.

Because of the financing exigencies of the house construction industry there are now many cases where a private individual does not arrange his own financing, but is required to assume the burden of a mortgage previously given by the builder. If the builder is incorporated, as often is the case, such a mortgage having been given by a corporation falls within the exemption provided by subsection 2. In such cases, the mortgagee may refuse the prepayment right conferred by subsection 1 to all successors in title to the corporation which gave the mortgage.

The reasons for enacting subsection 1 can be determined from the record of the Debates of the House of Commons for 1880.[11] The principal ones advanced were that long term mortgages tended to hamper the alienation of land, and that large bonuses or penalties were often exacted when mortgagors sought to prepay their mortgages. It was suggested that to hamper prepayment unduly would be detrimental to healthy competition among the mortgage companies.

The reasons for the enactment of subsection 2 are apparent from the following remarks made by Sir John Thompson in the House of Commons

[11]Canada, Debates of the House of Commons, 1880, 43 Vict., 2d Sess., 4th Parliament. See the debate on the second reading of Bill 11, 31 March, pages 953 to 977, especially pages 964 to 967.

in 1890 when he moved second reading of the bill introducing it into the *Interest Act*:[12]

> The operation of [subsection 1]...has led to considerable inconvenience in the case of parties applying for loans for long periods. Railway companies, for instance, desiring to make loans payable in 20 years, have been met with the objection that in Canada the law is such that the mortgage may be paid off at the end of five years; and lenders, of course, have found a material objection, that, inasmuch as the rate of interest may have fallen at the end of the five years, they should be compelled to take payment of principal and interest then due in anticipation of the time contemplated in the contract. For that reason, and to meet that inconvenience, a number of those companies themselves have required that the Act shall not apply to mortgages made by companies, and I shall acquiesce in that proposal.

It is evident from this statement that the sole reason for the enactment of subsection 2 was to assist companies to incur long term liabilities on the security of real property. When subsection 1 was the only provision in force, corporations offering bond issues secured by mortgages of real property could not in law bind themselves absolutely on the mortgages for effective terms greater than five years. This made the bond issues very unattractive to potential investors. By exempting from subsection 1 mortgages given by corporate mortgagors, subsection 2 enabled such corporations to offer to be bound for as long as necessary.[13]

The injustice of the effect of subsection 2 in the case of the incorporated builder-vendor selling a house to a private purchaser is self-evident. Subsection 2 was enacted to exempt from the prepayment provisions of subsection 1 certain types of debentures secured by or consisting of mortgages on real property. But the giving by a corporation of a mortgage on a dwelling-house which is subsequently bought by a private individual was never intended to fit into this exemption.

Subsection 2 determines exemption on the basis of the identity or status of a party to the mortgage contract, rather than upon the nature of the transaction of which the mortgage is an integral part. The working of subsection 1, which was enacted first, does not depend at all upon the identity or status of any person, natural or otherwise. Any mortgagor or his assignee is entitled to exercise the prepayment right if the mortgage satisfies the requirements of the subsection. The exemption granted by subsection 2 however, is determined by the identity of the mortgagor. But the rationale for subsection 2 had as its principal feature that certain

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[12]Canada, Debates of the House of Commons, 1890, 53 Vict., 4th Sess., 6th Parliament, at column 4266.

[13]Subection 2 further makes it possible for corporations to take advantage of what are now section 55 of *The Business Corporations Act, 1970*, S.O. 1970, c. 25 and section 64 of the *Canada Corporations Act*, R.S.C. 1952, c. 53 and create mortgages having perpetual terms. Section 64 of the Canada Act states:

> A condition contained in any debentures or in any deed for securing any debentures is not invalid by reason only that the debentures are thereby made irredeemable or redeemable only on the happening of a contingency, however remote, or on the expiration of a period, however long, any rule or equity to the contrary notwithstanding.

types of transaction were being prevented inadvertently by subsection 1. It is with the nature of those types of transaction that the legislation should have concerned itself, not with the characteristics of mortgagors.

Although this error in principle made little difference in the late nineteenth century, conditions of modern financing tend to expose it in relation both to the incorporated builder-vendor situation and to other circumstances. It is a common practice, for example, where an individual desires to borrow money for a business enterprise on the security of a mortgage of land, to require that he incorporate a company, convey his property to that company, and borrow the money as a corporate entity. At the same time, if the individual wishes to use the company to pursue his business enterprise, other creditors may well require that he personally guarantee the company's debts. He may even be asked to guarantee the company's liability on the covenant of the mortgage. In the context of this situation and in view of the ultimate distribution of liability, the incorporation may have been a costly nuisance devised solely to avoid the prepayment legislation.

In their responses to our working paper, most institutional lenders asserted that although they recognized these problems in the legislation, it was not and would not be their practice to insist on the technical right to deny prepayment, which is created by subsection 2, when dealing with an individual who had bought his home from a building company. Although such a public-spirited attitude is laudable, nevertheless the Commission believes it to be improper to leave the intended right to prepay solely to the grace of mortgagees. With the growth of condominium housing the number of home-owners who may have to rely on that grace could increase significantly.

III. Resolving the Problem

The Commission considered two solutions to the problem. The more obvious, and the more restricted in application, is merely to add a new subsection 3 to the section specifically exempting from the operation of subsection 2 a mortgage of a dwelling-house, or of a dwelling-unit in a multi-unit structure, where the mortgagor is a natural person.[14] Such an approach would certainly eliminate the problem which was principally responsible for our study. But it would not enable natural persons to borrow for commercial purposes and satisfy their creditors that they had divested themselves of the prepayment right without incorporating.

The second solution would be to repeal subsection 2 entirely and to substitute for it a provision for exemption from subsection 1 where a mortgage is a security or where it secures a security and where the property charged by the mortgage is in whole or in part an asset of or

[14]Note that by section 1 (*d*) of *The Mortgages Act*, the term "mortgagor" in the Act includes any person deriving title under the original mortgagor or entitled to redeem a mortgage, according to his estate, interest or right in the mortgaged property.

used in conjunction with a business or trade.[15] The term "security" would be defined as it is in section 1 (1) 27 (i), (ii), (v), and (vi) of *The Securities Act, 1966* of Ontario.[16] Thus, it would include:

> i. any document, instrument or writing commonly known as a security,
>
> ii. any document constituting evidence of title to or interest in the capital, assets, property, profits, earnings or royalties of any person or company,
>
> . . .
>
> v. any bond, debenture, share, stock note, unit, unit certificate, participation certificate, certificate of share or interest, pre-organization certificate or subscription,
>
> vi. any agreement providing that money received will be repaid or treated as a subscription to shares, stock, units or interests at the option of the recipient or of any person or company,
>
> . . .
>
> whether any of the foregoing relate to a person, proposed company or company, as the case may be.

The object of this solution is to exempt a mortgage from the operation of subsection 1 only where the mortgage is given to raise capital for a commercial enterprise or to assist in raising capital for a commercial enterprise through the issue of debentures or securities. It would provide an exemption from the right to prepay where a mortgage is used directly as a means of obtaining capital [17] or where it is used to assure the holders of a security that they will have a fund from which they can in certain circumstances be paid.[18]

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[15]This formula follows in part the style of what used to be section 59 of *The Corporations Act*, R.S.O. 1960, c. 71, and is now section 55 of *The Business Corporations Act, 1970*, S.O. 1970, c. 25. This section first appeared in the Statutes of Ontario as S.O. 1953, c. 19, s. 59. It is similar to section 64 of the *Canada Corporations Act*, R.S.C. 1952, c. 53. The Canada provision was first enacted by S.C. 1914, c. 23, s. 3. Section 55 of *The Business Corporations Act, 1970* states:

> A condition contained in a debt obligation or in an instrument for securing a debt obligation is not invalid by reason only that the debt obligation is thereby made irredeemable or redeemable only on the happening of a contingency, however remote, or on the expiration of a period, however long.

In the old Ontario Act, the section referred to "security" rather than "debt obligation", but by virtue of the new section 1 (1) 24 "debt obligations" are defined as a variety of security. Section 64 of the Canada Act uses the term "debenture", as does a similar English section. The English section has been held by the House of Lords to include mortgages within its ambit. In the present context the terms "debenture", "security", and "debt obligation" are all roughly equivalent and the effect of section 55 is therefore to permit a corporation to mortgage real property on any variety of condition as to duration and determination of term, even for an unlimited period, without falling foul of the equitable rule against "clogging the equity of redemption". Thus, at least in the law relating to corporations, and by inference in commercial law generally, there is an understanding of what is a "security" and that a mortgage may in certain circumstances be categorized as one.

See, *Knightsbridge Estates Trust, Ltd.* v. *Byrne*, [1940] A.C. 613; [1940] 2 All E. R. 401, which concerned s. 74 of the *Companies Act*, 1929, 19 & 20 Geo. 5, c. 23, now s. 89 of the *Companies Act*, 1948, 11 & 12 Geo. 6, c. 38.

[16]S.O. 1966, c. 142.

[17]*I.e.*, where the mortgage is a security.

[18]*I.e.*, where the mortgage secures a security.

The further requirement that, in addition, the property charged by the mortgage be in whole or in part an asset of or used in conjunction with a business or trade, purports to prevent a person who owns a business as a sole proprietor from losing the benefit of subsection 1 if he mortgages his residence and puts the money into the business. This would not, however, prevent the owner of a retail business who lives over his store or the owner of an apartment building who resides in one of the apartments from losing the prepayment right if he mortgages the business or apartment house property. In such a case the private residence has become indivisible from the public enterprise and one cannot with any certainty separate the two characters of the property. Some further consideration would have to be given in this regard to the position of farmers and people such as doctors and dentists whose practices are conducted from their homes. In view, however, of our ultimate choice of solutions we shall not go more deeply into these issues in this Report.

One of the advantages of the approach just outlined is that it would put the incorporated builder-vendor problem to rest, while at the same time it would enable a natural person[19] to mortgage land for a business purpose and satisfy the lender that he will not be subject to early prepayment without the necessity of incorporation.[20]

Choosing between these two approaches, the one narrow and the other broad, has been difficult. The Commission has decided however, to recommend the first approach which applies particularly to the incorporated builder-vendor. Despite the merits of the second solution we feel it best at this stage to interfere with current commercial practices as little as possible. It is therefore preferable to adopt the first solution now and to reconsider the second solution in the course of a full review of *The Mortgages Act* at some future date.

The Commission therefore recommends that a new subsection be enacted providing that subsection 2 does not apply to a mortgage of a dwelling-house or a dwelling-unit in a multi-unit structure where the mortgagor for the time being is a natural person.[21] The term "dwelling-house" should be defined as any building or part of a building kept or occupied as a single or double family residence. The phrase "dwelling-unit in a multi-unit structure" should be defined to mean a unit under *The Condominium Act, 1967*[22] which is kept or occupied as a single or double family residence. The term "natural person" should be defined to include any person[23] who holds an interest as mortgagor in a fiduciary capacity for a natural person. Apart from this special expansion of meaning, the term "natural person" would have its ordinary sense and

[19]And hence also partnerships.

[20]It is not doubted, although unusual, that a natural person can issue a "security". See Gower, *Modern Company Law* (2d ed., 1957), at p. 323, footnote 22, regarding "debentures".

[21]In *The Mortgages Act* the word mortgagor includes any person deriving title under the original mortgagor or entitled to redeem a mortgage, according to his estate, interest or right in the mortgaged property. (See s. 1 (d)).

[22]S.O. 1967, c. 12.

[23]Defined by *The Interpretation Act*, R.S.O. 1960, c. 191, s. 30 (28), to include a corporation, and the heirs, executors, administrators or other legal representatives of a person.

mean "human beings, as distinguished from artificial persons or corporations recognized by law."[24]

IV. Other Difficulties Arising out of Section 16

Two further matters were raised in submissions received by the Commission in response to the working paper. The first relates to the words "in lieu of notice" in subsection 1. The second is concerned with the effect of renewal or extension agreements.

(a) *Three Months Interest or Three Months Notice?*

Confusion exists as to whether a mortgagor desiring to prepay must always tender three months interest as a penalty, or whether he may give three months notice instead and avoid payment of any penalty at all. The only reported case on this issue is *Payment* v. *Prudential Insurance Company*,[25] in which it was held that the words "in lieu of notice" in section 10 (1) of the *Interest Act* did not permit a mortgagor to give three months notice as a substitute for paying three months interest. A grammatical reading of the subsection does not permit any other interpretation. The decision, however, was that of a lower court and so does not put the issue to rest finally. The legislation should therefore be made clear. This can best be accomplished by deleting entirely the words "in lieu of notice" from the subsection. The phrase adds nothing to the effect of the section. It merely explains that because a mortgagor may tender prepayment "at any time" his mortgagee is justly entitled to compensation.

(b) *Renewals or Extensions and The Prepayment Right*

The second point arises out of the trend in house financing to the five year term, renewable mortgage.[26] It has become a practice among some conventional mortgage lenders to make the term of a mortgage unequal to its period of amortization. On new houses, the term usually is kept to five years while the amortization period may run to twenty or twenty-five years, a practice which makes the loan renegotiable at the end of every five years. If there is an upward trend in interest rates the five year term benefits the lender.

Although until recently mortgages under the *National Housing Act* could not be drawn this way, one of the recommendations contained in the *Report of the Federal Task Force on Housing and Urban Development*[27] contained a suggestion that because of the needs of some lenders the requirements of N.H.A. loans should be made more flexible. At page 30 of the Report the statement is made that "[m]ortgages with a five year term, for example, would seem to offer a more attractive investment." Pursuant to this aim, it was announced on April 23, 1969 that the

[24]See Jowitt, *The Dictionary of English Law* (1959), page 1209.
[25](1959), 28 W.W.R. 197 (Alta. Dist. Ct.).
[26]In this context the word "extension" might be more appropriate than "renewal". Current practice, however, seems to make little if any distinction between these terms. The term "renew" should therefore be read with this in mind.
[27]Published in January, 1969.

regulations under the *National Housing Act* would be altered to permit the creation of short term N.H.A. mortgages and N.H.A. mortgages for which the interest rates might be revised after periods as short as five years.[28] The amortization periods of the loans secured by these mortgages would still have to be at least twenty-five years. Formerly, the interest rates on N.H.A. loans were unalterable over the full periods of their amortization.

The popularity of the short term mortgage among lenders raises the question whether a mortgage for five years or less can become subject to the prepayment right set out in subsection 1 if it is renewed and the new date for termination is set beyond five years from the date at which the mortgage was originally given. There is also the supplementary issue whether it makes any difference for the renewal to be made pursuant to a renewal clause contained in the mortgage document itself or pursuant to an agreement to renew extrinsic to the mortgage document.

Some lenders are of the opinion that the renewal represents a new agreement and that the five-year period must therefore be re-calculated from the date of renewal. Others assert that there is no right to prepay if on the face of the mortgage document the term of the mortgage is not for more than five years. These views, however, ignore the facts that by the terms of the legislation the five-year period runs from the date of the mortgage, in other words from the date that the conveyance to the mortgagee of the original mortgagor's interest was made, that renewal in this context merely alters the date for termination, and that if renewal truly effected a new mortgage contract there would be doubt as to whether priority for the principal debt over second and later encumbrances could be preserved. In this last instance no renewal could safely be made without getting subsequent encumbrancers to agree to the postponement of their interests.

There are no reported cases on these points but from a careful reading of subsection 1 it appears that renewal or extension does not interfere with the running of the time whereby the right to prepay is determined and that it makes no difference how the renewal or extension is effected. Any other decision could lead to a constantly renewed mortgage contract which would negate the policy of subsection 1, that all private (as opposed to commercial) mortgages should be open after their first five years.

An alteration in the interest rate upon renewal seems to have no effect on this conclusion and has significance only with respect to priorities. If a formula or provision for altering the rate were set out in the renewal clause in the mortgage an increased rate would prevail over the interests of subsequent encumbrancers. If the higher rate were stipulated only in an agreement extrinsic to the mortgage document, priority might be lost to the extent of the increased interest, but not as to interest at the old rate and unpaid principal.

The phrase in the section which leads to confusion about the effect of renewal or extension is, "under the terms of the mortgage". These

[28]See S.O.R./69-178.

words suggest to some that to be subject to the prepayment right the mortgage must be for more than five years on its face and when it is created. But such a view takes no note either of the status of a renewal clause itself as a "term of the mortgage", or of the power of parties to vary the terms of a document by an extrinsic agreement.[29] The addition to this phrase of a reference to renewal or extension agreements would be sufficient to eliminate the misunderstanding. The passage would then read, "under the terms of the mortgage or of any renewal or extension thereof".

The Commission is apprehensive, however, that the change just suggested could lead to a rash of demands for payment and discharges, and the creation of a new mortgage whenever a five year term expires. Since mortgagors would undoubtedly be required to pay legal and other fees incumbent on this occurrence, legislation enacted for their benefit would in fact be creating an additional and unnecessary burden for them.

A better solution is to include also a reference to replacement mortgages so that the phrase in question would be, "under the terms of the mortgage or of any renewal, extension or replacement thereof". A replacement mortgage should be defined as any mortgage which secures an advance which in whole or in part is used to pay off a loan secured by a mortgage taken or held by the same mortgagee.

The Commission has sought the views of lending institutions on this matter by means of informal discussions with knowledgeable executives. Objections were made, particularly on behalf of trust companies, that to add the term of a renewal or of a replacement mortgage to the term of the original mortgage in ascertaining when the prepayment right arises would cause serious money management problems. Stated in simple terms, the root of the difficulty is asserted to be that it is not feasible to make mortgage loans which may be of shorter duration than the commitments undertaken by the lender to finance them. Lenders do not wish to put themselves in a position where they have borrowed money for fixed periods and have in turn lent it for indefinite and perhaps shorter periods. If interest rates fall or if the cost of doing business rises, a lender who has done so may find that the spread between the rate at which he has borrowed and the rate at which he has lent has diminished dangerously or is no longer adequate. Lenders adhering to this point of view would prefer to see the Act amended to allow renewals of five year term mortgages to be treated as new mortgages for the purposes of section 16.

It appears that it is now the practice of some lenders when engaged in financial planning and when dealing with borrowers, to treat renewals of mortgages for five years as creating new five year terms. Apart from concessions in the mortgage agreement itself they prefer to view a five year term mortgage as closed, even when renewed or extended. However, as has been pointed out, this is not the effect of the present law. The

[29]Subject that is, to *The Statute of Frauds*.

growth of this practice leads uninformed owners of property subject to mortgage to refrain from exercising a right given them by the legislature. On the other hand, it has been suggested that to ensure the strict observance of the present law, or even just to make it more readily apparent by amending the statute, might cause a flight of capital from the residential mortgage market.

After careful consideration the Commission does not acquiesce in the objections raised by the lenders. The policy of section 16 of *The Mortgages Act* and of section 10 of the *Interest Act* is that all non-commercial mortgages should be open after their first five years. The coupling of five year term mortgages with the principle that on renewal a new term starts to run for the purposes of calculating when the prepayment right arises, effectively negates that policy. To amend the provision to achieve this effect is equivalent to repeal. The Commission considers that the benefit of section 16 to home buyers, if properly implemented, rules out any question of the wisdom of repeal.

The Commission therefore recommends that in section 16 (1) the phrase "under the terms of the mortgage" should be expanded to read "under the terms of the mortgage or of any renewal, extension or replacement thereof". A replacement mortgage should be defined as any mortgage which secures an advance which in whole or in part is used to pay off a loan secured by a mortgage taken or held by the same mortgagee.

V. Entrenchment Against Contracting Out

In the course of this project the Commission was also concerned whether it was necessary to entrench the right to prepay against waiver or contracting out. Unless there is legislation to prohibit it, or it would be contrary either to public policy or the policy of the statute, there is no bar to an individual waiving his right to a benefit conferred by statute.[30] It is not certain whether section 16 of *The Mortgages Act* and section 10 of the *Interest Act* represent statutory benefits susceptible to such contracting out. But if only because of this uncertainty, the careful solicitor for a mortgagee who is unwilling to be prepaid must be expected to include a waiver clause in the mortgage if he can.[31]

Regardless of how the courts would decide were they faced with the specific issue whether such a waiver is effective, in view of the doubt as to the degree to which the right to prepay is entrenched some clear legislative statement is desirable. The Commission therefore recommends that a subsection be added to the legislation making it impossible to waive or to contract out of the benefit of section 16.

VI. Retrospective Operation of the Proposed Amendments

The Commission has also considered whether, if the recommendations in this Report are implemented, mortgages which are already in

[30]See Halsbury, *Laws*, Vol. 36 (3d.ed., 1961), "Statutes", at para. 673; and 21 *C.E.D.*, "Waiver", at para. 20; and the cases cited therein.

[31]See, for example, a waiver clause mentioned without disapproval by the Ontario High Court in *Re Moore and Texaco Canada Ltd.*, [1965] 2 O.R. 253, at page 256.

existence at that time should be affected. To limit the operation of the new provisions to mortgages executed subsequent to their coming into force could deny some citizens, for long periods, the relief which ought to be theirs.

For this reason and because of the intent and policy of section 16 of *The Mortgages Act* and of section 10 of the *Interest Act*, we have concluded that the amendments should apply, not only to mortgages to be created in the future, but also to all mortgages in effect at the date of the amendment. The changes recommended would cause the better implementation of principles which have always been present, although imperfectly expressed, in the two Acts.

The effect of giving retrospective operation to the proposed amendments would be that any mortgage of a home in Ontario, where the equity of redemption is held by a private person, regardless of when the mortgage was created, could be prepaid at any time after five years from its date of creation. Several lenders were consulted as to whether there might be any objections to this effect. No objections were raised or envisaged.

The Commission therefore recommends that the changes in legislation recommended in this Report be made applicable not only to mortgages to be created in the future, but also to all mortgages in effect at the date of the amendment.

VII. Summary of Recommendations

The Commission recommends that:

1. Subsection 1 of section 16 of *The Mortgages Act* be amended so that the clause "no further interest is chargeable, payable or recoverable at any time thereafter on the principal money or interest due under the mortgage" is deleted, and a new clause added such that where a mortgagor could formerly have offered prepayment he may now require acceptance of such prepayment and demand a discharge of the mortgage,

(See page 8)

2. A new subsection be added to section 16 of *The Mortgages Act* declaring that subsection 2 does not apply to a mortgage of a dwelling-house or a dwelling-unit in a multi-unit structure where the mortgagor for the time being is a natural person. The term "dwelling-house" should be defined as any building or part of a building kept or occupied as a single or double family residence. The phrase "dwelling-unit in a multi-unit structure" should be defined to mean a unit under *The Condominium Act, 1967*, S.O. 1967, c. 12, which is kept or occupied as a single or double family residence. The term "natural person" should be defined to include any person who holds an interest as mortgagor in a fiduciary capacity for a natural person. Apart from this special expansion of meaning, the term

"natural person" would have its ordinary sense and mean "human beings, as distinguished from artificial persons or corporations recognized by law",

(See pages 12 and 13)

3. In subsection 1 of section 16 of *The Mortgages Act* the words "in lieu of notice" be repealed,

(See page 13)

4. In subsection 1 of section 16 of *The Mortgages Act*, the phrase "under the terms of the mortgage" be expanded so as to read "under the terms of the mortgage or of any renewal, extension or replacement thereof", and that a replacement mortgage be defined as any mortgage which secures an advance which in whole or in part is used to pay off a loan secured by a mortgage taken or held by the same mortgagee,

(See page 16)

5. A further new subsection be added to section 16 of *The Mortgages Act* declaring that no waiver of or agreement not to pursue any rights conferred by the section shall be effective or binding upon any mortgagor where such mortgagor is a natural person,

(See page 16)

6. The changes in legislation recommended in this Report apply, not only to mortgages to be created in the future, but also to all mortgages in effect at the date of the amendment.

(See page 17)

We wish to express our appreciation to the corporations, organizations and individuals with whom we corresponded in the course of our work on this project. We are grateful for the time and attention which they gave to our inquiries.

We want also to thank Maurice J. Coombs, one of our research officers, for his capable and scholarly assistance in the conduct of the necessary research and the drafting of this Report.

All of which is respectfully submitted.

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Chairman.

JAMES C. MCRUER,
Commissioner.

RICHARD A. BELL,
Commissioner.

W. GIBSON GRAY,
Commissioner.

WILLIAM R. POOLE,
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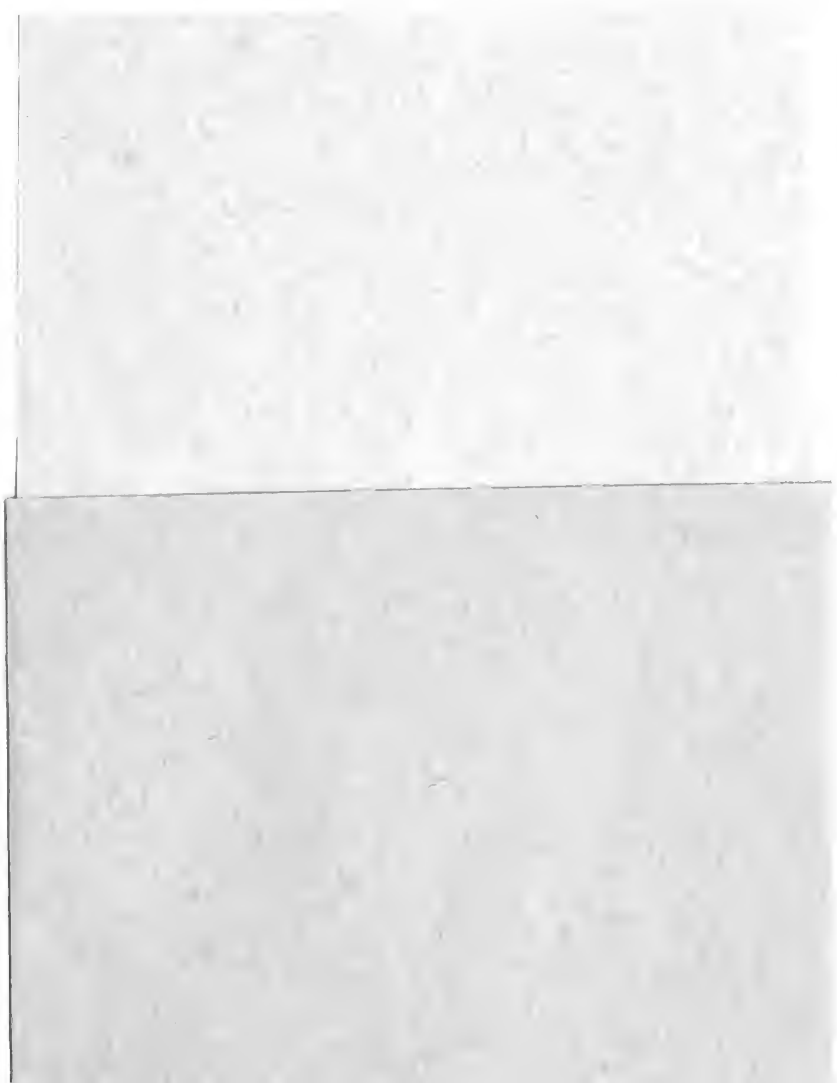
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